

by the *Schumacher* reasoning, the court's action may possibly represent a *sub silentio* repudiation of its earlier construction of Sec. 5385. Such repudiation, it is true, would be unnecessary for the stone crushing concerns themselves, for they had meanwhile found relief in the legislature. By the 1939 amendment of Sec. 5388, not only they, but farmers and towel and linen suppliers as well, had gained the 50% rate.<sup>16</sup> This followed by some years similar legislative relief<sup>17</sup> from unfavorable lower court judgment<sup>18</sup> as to the nature of the operations of laundries and dry cleaners; and preceded by a biennium the 1941 addition of Sec. 5388-5,<sup>19</sup> which anticipatorily does the same for rural electric cooperatives. Indeed, in these repeated legislative expressions of dissatisfaction with the judicial handling of the problem may be found the cue to the Supreme Court's present gratuitous *dictum*. For, although technically they involve no effort to define as "manufacturing" the activities of the named businesses, there is manifest in them as a legislative intent that Sec. 5385 enjoy a liberal interpretation. Very possibly, therefore, it was to avoid the unsatisfactory alternative of likely continued legislative patch-work that the court went beyond the requirement of the case before it to put its decision on a "broader ground," hoping thereby to impute into the definitional section an acceptable basis for administration of this important aspect of Ohio's taxation of tangible personalty.

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#### TREATMENT OF CREDITS UNDER OHIO INTANGIBLE TAX LAWS—ADVANCE PAYMENTS NOT ACCOUNTS PAYABLE

Taxpayer, a manufacturer of machinery on special order, requires its customers to advance monies before delivery. In returning its personal property for Ohio taxation, taxpayer claimed a deduction of such advances from its "credits" under Ohio Gen. Code Sec. 5327, the controlling portion of which reads: "The term credits as so used, means the excess of the sum of all current accounts receivable and prepaid items used in business when added together estimating every such account and item at its true value in money, over and above the sum of current accounts payable of the business, other

<sup>16</sup> 118 Ohio Laws 609.

<sup>17</sup> 115 Ohio Laws 564.

<sup>18</sup> *Laundry and Cleaning Co. v. Tax Comm.*, 30 N.P. (N.S.) 25, *aff'd*, 14 Ohio L. Abs. 357 (1932).

<sup>19</sup> 119 Ohio Laws 215.

than taxes and assessments. 'Current accounts' include items receivable or payable on demand or within one year from the date of inception however evidenced." The Board of Tax Appeals sustained the tax commissioner in denying the deduction. On appeal under Ohio Gen. Code Sec. 5611-2, *held*, affirmed, one judge concurring and one dissenting. *Black-Clawson Co. v. Exatt*, 139 Ohio St. 100, 38 N. E. (2d) 403 (1941).

The majority, declaring the statute so clear as to admit of but one interpretation, held the advance payments to be outside the legislative authorization for deduction. Their reasoning took the tack that such advances were not in fact liabilities but only contingent obligations, inasmuch as the taxpayer would not be obligated to reimburse its customers except on failure to deliver the machinery ordered; consequently, they were not current accounts payable as statutorily defined. By legal definition, however, such advances from customer to manufacturer are definite liabilities of the latter;<sup>1</sup> while accountants are in substantial agreement that they should be treated as current liabilities.<sup>2</sup> Justification for this view is evident upon analysis of the current financial position of any business enterprise. Current funds—cash, receivables, and inventory—available to satisfy current obligations, constitute a business's current assets. The obligations which must be so satisfied are the enterprise's current liabilities. From the relationship of current assets to current liabilities is deduced the current ratio, one of the most significant signposts of business finance. The cash advanced by customers or the inventory converted therefrom, is a current asset; to fail, therefore, to treat as a current liability the contract obligation which will consume this asset, would permit the current ratio to reflect a false picture of the

<sup>1</sup> *Vandalia R. R. Co. v. Keys*, 91 N. E. 173 (1939).

<sup>2</sup> SANDERS, HATFIELD, AND MOORE, *A STATEMENT OF ACCOUNTING PRINCIPLE*, (1938) 83, in discussing credits to income, state: "Amounts received from customers in advance in the regular course of business are, strictly speaking, a mixture of liabilities and profit. In so far as they call for merchandise or services to be rendered in the future, the cost of such merchandise or services represents a liability. If such cost is a predominate element in the amount received in advance and if the merchandise or services are to be rendered in the near future, there is much to be said for the general practice of not attempting to segregate the profit element from the cost and of showing the whole amount received as a current liability rather than as a deferred credit to income. If the cost of the merchandise or services is only a small part of the amount received, the whole of that amount may properly be shown as a credit to income rather than a current liability." See also HOLMES, *AUDITING PRINCIPLES AND PROCEDURE* (1939) 319; TAYLOR AND MILLER, *INTERMEDIATE ACCOUNTING* (2d ed. 1938) 128; PATON, *ACCOUNTANT'S HANDBOOK* (2d ed. 1933) 153, 337, 376.

taxpayer's current financial position; consequently, the advances must be classified as a specie of current liability.

However, it does not follow from this, as the dissenting judge reasoned, that the theory of the statute is to gauge tax capacity from the current ratio. Though properly a current liability, in the normal course of business the taxpayer's obligation will require, not payment in money but rendition of service by the manufacture and delivery of the machinery ordered; only upon failure to fulfill the expectations of the contract will there be a duty to return the monies to the customer. Yet the statute speaks of items "payable on demand or within one year," language which in legal and accounting circles carries a connotation of payment in specie, rather than in service.<sup>3</sup> Contemporary writers advance the theory that legislative intent, in any immediate sense, is a fiction, and that the most adequate solution to the problem of statutory interpretation seems therefore to lie in adapting "the reasonable man" guide of other areas of the law.<sup>4</sup> The foundation for this theory is the belief that much of modern legislation constitutes merely the sovereign declaration of private custom; consequently, legislative intent is to be found, if at all, in crystallized social or business practice, especially in the case of specialized branches of legal control.<sup>5</sup> In the principal case, certainly, such an approach would deny to the taxpayer the deduction he claimed, as one not within the intendment of the statute although admittedly a current liability.

Concurring, Judge Turner did embrace this theory of statutory intention to reach the correct result, but for a different reason. Rather than emphasizing the second sentence of Sec. 5327, with its requirement of payment on demand or within a year, the Judge found the measure of possible deductions in the reference of the first sentence to "current accounts payable."<sup>6</sup> Then, reviewing the accounting authorities, he concluded that the monies advanced to and held

<sup>3</sup> 1939 Atty. Gen. Opns. No. 345.

<sup>4</sup> Jennings, *Judicial Process at Its Worst* (1937) 1 Mod. L. Rev. 111; Horack, *In the Name of Legislative Intention* (1932) 38 W. VA. L. Q. 119; GRAY, *THE NATURE AND SOURCES OF THE LAW* (1921) 172-173; Radin, *Statutory Interpretation* (1930) 43 HARV. L. REV. 863; Landis, *A Note on "Statutory Interpretation"* (1930) 43 *id.* 886.

<sup>5</sup> HORACK, *CASES AND MATERIALS ON LEGISLATION* (1940), 602.

<sup>6</sup> Tax Comm. v. Kelly-Springfield Tire Co., 38 Ohio App. 109, 175 N. E. 700 (1931). It was held in this case that the old section, effective prior to 1933, allowed deductions of all claims, demands and debts whatsoever. The present amendment limits the deductions permissible and requires that they be business accounts. The requirement that the "items" be used in business has never been litigated before. It remains an open question whether or not a judgment in tort would be classed as a current account payable.

by the taxpayer were not properly to be considered as accounts payable. In this he was without question correct;<sup>7</sup> to an accountant, an account payable is limited to liabilities arising from the purchase of goods or services used in the business.<sup>8</sup> But whether the statute's first sentence carries the controlling definition is open to serious doubt. Its phrases "current accounts receivable" and "current accounts payable" are there used not definitionally but to convey the legislative determination to permit of a taxable *net* value.<sup>9</sup> Of what "current accounts" consist is revealed by the language of the second sentence—"items receivable or payable on demand or within one year from the date of inception, however evidenced." If this reading of the statute be correct, Judge Turner's conclusion would unwarrantedly delimit the deductions covered by the taxing provision. Short-term bank notes, wages, rent, insurance, and sundry other items, while not strictly current accounts payable, constitute accrued expenses normally payable within a year if not on demand.<sup>10</sup> So also deposits held by utility companies as security for payment of bills are not classified as current accounts payable but are nevertheless payable on demand upon discontinuance of the service by the customer. By the prevailing opinion they should be deductible, just as advances on future orders should not, despite the majority's confusion over the proper reason for denying the claim made in the principal case.

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<sup>7</sup> As to the interrelation of accounting and law see Kristeller, *Some Problems Common to the Practice of Law and Accounting*, in Ohio State Univ. Pub. College of Commerce Conf. Ser., No. 7, 33 (1939).

<sup>8</sup> BUDD AND WRIGHT, *THE INTERPRETATION OF ACCOUNTS* (1933) 340; Paton, *op. cit. supra* note 2, at 339; BOLON AND ECKELBERRY, *INTRODUCTION TO ACCOUNTING* (2d ed. 1938) 13.

<sup>9</sup> *Supra*, note 3.

<sup>10</sup> HOLMES, *op. cit. supra* note 2, at 293.